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MORTGAGE BANKING

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COMPUTERS

Changing the Landscape

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DECEMBER 1989 VOLUME 50 NUMBER 3

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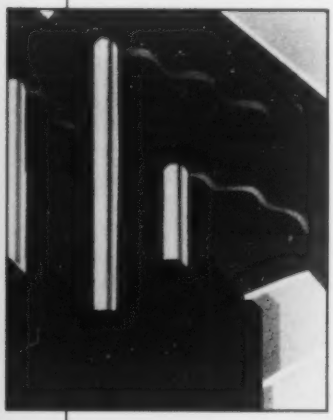

Working on a computer for the first time can be tough sledding. But when you are up to your ankles in paper—as many mortgage companies are—computers represent a glimmer of hope that there is a better way. So, if your processors are shoveling out from under too much paper, this issue should offer some good cheer. And, best wishes for a computer-literate new year.

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Computer Terminology

Computers have their winning ways about them. Just when you think you've had it with trying to learn computers—reading overly detailed, tedious descriptions of how to do something simple like turn the machine on—someone comes along and shows you a way to simplify your working life tenfold. That's it. You're hooked.

If ever there was an industry designed for computers, it's mortgage lending. It's amazing that automation has taken so long to get a grip on this business of forms and more forms. But then again, maybe it is not so amazing if you consider that IBM just discovered the mortgage banking industry two short years ago. Where was it when you needed it? Well, there's no worrying about the reasons now. IBM is here, with its corporate sights set on you. This issue carries a feature on the new marketing team IBM has fashioned to help sell you on doing business better with its ideas, with the software vendors the company has teamed up with and with its technology.

Then there's something called imaging—technology that stores document images in digital form so computers can pull up the stored data instantly. Servicing departments may never be the same. Countrywide is blazing the trail using this technology, and the story is an interesting one. It makes microfiche look positively archaic.

Computers also can help lenders spot suspicious details in loan originations, such as two loans written for the same individual who said each property—in different locations—would be owner occupied. Hard to do—yes, virtually impossible. But Travelers has developed a sophisticated set of databases that permit crosschecking facts to sniff out the bad loans early on.

Finally, a computer and an art director came together for the first time to produce this month's cover. Kudos to Sarah Hollander. Happy Holidays to all our readers, and brace yourselves for another challenging year. We will revisit computers in February to see if you learned anything in the interim.

Janet Reilley Hewitt
Editor

COMING IN JANUARY

More Nice Weather

The economic outlook is the subject of our first issue of the next decade. The forecast is for a further cooling of growth and a breakup of the dark storm clouds of inflation that hovered on the horizon this year. In the words of Lyle Gramley: "The problems of economic overheating . . . are now over." The question now is, How chilly will it get?

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Banks' portfolios are looking more and more like thrifts'. What are the odds that the thrift industry's problems will be repeated?

BANKS HOW HEALTHY ARE THEY?

William C. Ferguson

On the surface, the financial health of the commercial banking industry looks robust. Industry earnings for 1988 rebounded sharply from the dismal performance of 1987. Earnings for the first and second quarters of 1989 remain strong, and earnings for 1989 as a whole will probably surpass 1988.

However, in spite of high reported earnings for the banking industry overall, the picture is not as rosy as it seems. In my view, it would be a mistake to take the savings and loan debacle too lightly. Economic, competitive, technological and legal changes will continue to buffet the entire financial system, and depository institutions in particular.

The pace of change seems to be accelerating, and we—financial analysts, regulators, managers and lawmakers—may not be able to predict, or even comprehend, and respond to these changes.

Now with FIRREA behind us, I expect we will hear a new series of debates concerning the wisdom and necessity of reforming the structure of financial institutions and the deposit insurance system. In response to the growing number of financial institution failures, many proposals have been offered to radically restructure the financial institutions system and the deposit insurance system. Although these proposals may provide a foundation for theoretical discussion, most are impractical in the real world.

It is my view that substantial and fundamental improvements in the safety and soundness of the banking system and its deposit insurance fund can be achieved with modest changes.

This article focuses on three arenas:

- Factors influencing the health of the banking industry.
- The current state of the industry.
- Prospective condition of the commercial banking industry and the Bank Insurance Fund (BIF).

This article includes certain financial information pertaining to the commercial banking industry. For purposes of this article, the information omits data pertaining to savings banks insured by BIF.

All financial information presented was derived using computer tapes generated by BIF and purchased from the U.S. Department of Commerce. Such tapes contain final financial information through 1987 and preliminary financial information for the year ended Dec. 31, 1988, and the three months ended March 31, 1989 (the latest data released by BIF). Since amended reports may be filed by commercial banks after preliminary tapes are released by BIF, the financial information included in this article may differ somewhat from information prepared by BIF for other forums. However, such differences are not expected to be significant enough to affect the validity of the analysis or conclusions reached in this article.

Banking during the next decade

A variety of forces will change the structure of the banking industry during the next decade. These factors include the following:

- *Continued deregulation of entry.* Interstate banking will accelerate as legal barriers continue to disappear. As a result of FIRREA, cross-industry acquisitions will be numerous and will become commonplace.
- *Competition and continued cost pressures.* Deregulation will result in unrestricted competition in the financial services industry. As a result, both the asset and liability sides of the balance sheet will be under pressure, and interest margins will tend to become narrower. Institutions will be forced to continue searching for more efficient ways to deliver financial services and, in the process, achieve greater economies

of scale. In addition to competition among commercial banks, competition will also come from nondepository institutions such as money market funds, Fannie Mae, Freddie Mac and the investment banking community.

- *Regional economic and demographic trends.* Financial institutions in distressed or declining areas will remain in jeopardy. High-quality credits will be scarce in these areas, and many institutions will find it difficult to survive on the spread that can be obtained from investment income. The Southwest economic crisis has demonstrated the pitfalls that await those financial institutions attempting to survive in depressed regional economies.
- *Overcapacity and consolidation.* We are an "overbanked" nation served by too many depository institutions. With increasing competition and reduced interest margins, the overcapacity will probably lead to a rapid wave of consolidations. Even today, we have a smaller number of commercial bank charters than at any time since the Great Depression. In addition to pressures from competitive forces, mergers and acquisitions will be driven by increased capital requirements and perceptions as to economies of scale. It is not unreasonable to expect that the number of "banking" offices of all depository institutions will be reduced considerably by the end of this century.
- *Restructuring of bank balance sheets.* As commercial and industrial loan demand has shifted from commercial banks to the investment banking community, concentration in real estate lending by commercial banks has grown steadily during the last several years. As experience in the thrift industry has demonstrated, real estate lending provides the potential for incurring substantial interest rate risk and loan losses. The balance sheets of many commercial banks today look similar to those of thrifts of yesteryear.

In summary, absent any return to regulation of deposit costs, the commercial banking industry will continue to experience a large number of voluntary mergers, involuntary mergers and liquidations as the nature of the industry continues to change.

The balance sheets of many commercial banks today look similar to those of thrifts of yesteryear.

The primary public policy issue is how to adapt the regulatory, supervisory and deposit insurance system so that the safety and soundness of the financial system, the deposit insurance funds and the payments mechanism is ensured as we enter the rapidly changing decade of the 1990s.

In short, what is needed to preserve the stability of the system is more rigorous enforcement of capital standards coupled with more timely and accurate financial data to provide additional protection to BIF.

However, a more rapid regulatory response system, including an early intervention program, will also be needed, not only to protect BIF but also to ensure the stability of the banking system.

Nevertheless, even with improved regulatory policies and a favorable external economic environment, competition and technology will create a high level of financial institution mergers, and perhaps failures, during the next decade.

Current state of the industry

Ferguson & Co. collected data that show some financial highlights for the commercial banking industry for 1986, 1987 and 1988 and for the three months that ended March 31, 1989, segregated by asset size of the institutions. The industry is broken down by number of banks in each of the size categories show below in Table 1.

TABLE 1

Size	Number
Total Assets Greater Than $10 Billion	42
Total Assets $1–$10 Billion	328
Total Assets $100 Million to $1 Billion	2,445
Total Assets Less Than $100 Million	10,185
Total	13,000

The financial data indicate that the industry in general is well capitalized throughout all size categories. However, I expect the upcoming risk-based capital standards to require many banks with total assets of more than $1 billion to raise additional capital.

Additional data gathered show financial highlights for the commercial banking industry by region for 1986, 1987 and 1988 and for the three months ended March 31, 1989. While the banks in each region are, in general, well capitalized, there are significant differences in return on average assets by region. These differences are summarized in the following table:

TABLE 2

	Return on Assets			
	1986	1987	1988	3/31 1989
All Banks	0.66	0.12	0.76	0.95
Southwest Banks	0.01	(0.17)	(0.26)	0.19
Midwest Banks	0.79	0.73	0.91	1.22
Southeast Banks	1.07	0.96	1.00	1.00
Northeast Banks	0.79	(0.15)	0.98	0.88
Central Banks	0.91	0.43	1.08	1.11
West Banks	0.39	0.02	0.90	1.18

Translating these figures into dollars, banks as a whole enjoyed profits of $22.76 billion in 1988, while banks in the Southwest had losses of $609 million.

Chart 1 presents detailed financial information for banks in each state as of March 31, 1989. This chart shows a geographic pattern of troubled institutions that those familiar with the current state of the thrift industry will recognize.

Looking more closely at the numbers on a state-by-state basis, Texas, Arizona, Louisiana and Oklahoma (in that order) were the states with the worst performance for the first quarter of 1989.

There is some evidence that the worst is yet to come in the Southwest. For instance, nonaccrual loans increased from 3.88 percent of total loans at the end of 1988 to 4.88 percent at the end of the first quarter of 1989.

Similarly, owned real estate/total assets increased from 1.44 percent at the end of 1988 to 1.78 percent at the end of the first quarter of 1989.

Chart 1

All Commercial Banks

Selected Financial Information at March 31, 1989 (Dollars in Thousands)

		Balance Sheet									Income Statement						
		Total Assets	Equity Capital	Equity Capital/ Avg. Assets	Primary Capital	Primary Capital/ Avg. Assets	Loan Loss Reserves/ Total Loans	Nonaccrual Loans/ Total Loans	Net Chg-Offs/ Avg. Loans	ORE/ Total Assets	Net Income (Loss)	Return on Average Assets	Net Int. Income/ Avg. Assets	Prov. for Ln & Ls Loss/ Avg. Assets	Nonint. Income/ Avg. Assets	Securities Gains(Ls)/ Avg. Assets	Nonint. Expense/ Avg. Assets
AL Totals,	221 Institutions	$ 33,563,403	$ 2,747,503	8.25%	$ 2,953,534	8.87%	1.23%	0.66%	0.24%	0.18%	$ 91,518	1.10%	3.61%	0.25%	1.11%	0.03%	3.09%
AK Totals,	8 Institutions	3,711,213	403,585	11.13	427,046	11.78	2.23	5.31	0.94	0.53	9,886	1.09	4.15	0.45	1.34	0.01	3.74
AZ Totals,	46 Institutions	28,074,026	1,778,668	6.38	2,076,258	7.45	2.07	5.44	1.53	1.16	12,331	0.18	4.04	1.22	1.36	0.01	4.05
AR Totals,	256 Institutions	18,504,541	1,580,997	8.58	1,744,817	9.47	1.69	1.75	0.48	0.60	48,149	1.04	3.83	0.35	1.06	0.00	3.24
CA Totals,	473 Institutions	306,047,255	17,345,792	5.81	24,737,856	8.29	3.02	2.68	0.90	0.47	942,572	1.26	4.59	0.53	1.98	(0.00)	4.22
CO Totals,	446 Institutions	24,761,337	1,844,937	7.51	2,186,108	8.90	2.41	3.46	1.33	1.54	35,727	0.58	4.20	0.63	1.81	0.00	4.56
CT Totals,	70 Institutions	39,382,882	2,586,127	6.67	2,820,795	7.27	1.07	1.17	0.85	0.18	69,519	0.72	3.66	0.48	1.13	(0.03)	3.26
DE Totals,	45 Institutions	59,138,955	5,338,414	9.18	6,376,408	10.96	2.65	0.32	2.56	0.01	213,765	1.47	5.74	2.06	2.88	0.00	4.25
DC Totals,	25 Institutions	18,668,643	1,069,755	5.87	1,349,427	7.40	1.69	1.02	0.16	0.14	38,865	0.85	3.41	0.19	1.10	(0.00)	3.09
FL Totals,	415 Institutions	122,276,222	7,895,536	6.59	8,968,669	7.49	1.43	1.34	0.58	0.79	219,099	0.73	3.94	0.57	1.34	0.00	3.68
GA Totals,	382 Institutions	60,297,591	4,586,181	7.78	5,038,126	8.55	1.38	0.70	0.48	0.22	175,183	1.19	4.34	0.40	1.41	(0.01)	3.82
HI Totals,	22 Institutions	14,175,192	930,541	6.87	1,068,482	7.88	1.61	0.44	0.04	0.03	43,368	1.28	4.41	0.29	1.20	0.09	3.46
ID Totals,	22 Institutions	7,339,880	522,524	7.05	611,574	8.25	1.83	0.95	0.40	0.27	21,203	1.14	4.30	0.28	1.13	(0.04)	3.43
IL Totals,	1,140 Institutions	186,074,124	11,937,921	6.44	15,246,818	8.23	2.92	2.15	0.73	0.14	505,987	1.09	3.09	0.21	1.16	0.02	2.80
IN Totals,	331 Institutions	52,842,584	4,008,374	7.69	4,405,091	8.45	1.35	0.95	0.46	0.14	135,335	1.04	3.73	0.35	0.93	(0.03)	2.95
IA Totals,	583 Institutions	30,494,182	2,709,497	8.91	2,971,953	9.78	1.86	0.89	0.23	0.43	88,785	1.17	3.75	0.19	0.86	(0.01)	2.84
KS Totals,	577 Institutions	25,191,842	2,072,260	8.23	2,322,176	9.22	1.89	1.51	0.42	0.69	67,686	1.08	3.94	0.41	0.84	(0.01)	2.92
KY Totals,	332 Institutions	36,858,804	2,942,464	8.04	3,242,544	8.86	1.41	1.10	0.37	0.19	99,484	1.09	3.59	0.35	0.93	(0.02)	2.80
LA Totals,	247 Institutions	35,624,761	2,539,521	7.19	2,959,007	8.38	2.49	3.76	1.30	1.46	31,674	0.36	3.65	0.87	1.10	(0.02)	3.46
ME Totals,	19 Institutions	7,740,674	526,568	6.87	583,042	7.61	1.11	0.76	0.34	0.09	20,505	1.07	4.44	0.31	1.05	(0.03)	3.74
MD Totals,	102 Institutions	48,653,376	3,464,500	7.26	4,072,209	8.54	1.44	0.55	0.38	0.15	127,725	1.07	4.07	0.34	1.11	0.01	3.35
MA Totals,	104 Institutions	109,405,568	6,575,066	6.05	7,787,404	7.17	1.69	2.12	0.39	0.32	202,011	0.74	3.05	0.37	1.62	0.11	3.28
MI Totals,	284 Institutions	86,323,636	5,564,249	6.57	6,500,230	7.67	1.49	0.85	0.64	0.14	225,236	1.06	3.80	0.36	1.08	(0.02)	3.17
MN Totals,	681 Institutions	49,803,294	3,438,884	6.91	4,268,905	8.58	2.10	1.85	0.57	0.28	123,901	1.00	3.59	0.40	1.34	(0.04)	3.16
MS Totals,	123 Institutions	19,560,329	1,527,946	7.96	1,646,236	8.58	1.56	0.74	0.46	0.36	52,025	1.08	3.62	0.28	1.08	(0.01)	3.16
MO Totals,	566 Institutions	53,808,436	4,172,172	7.74	4,713,477	8.74	1.69	1.36	0.46	0.37	144,436	1.07	3.68	0.37	1.11	(0.00)	3.02
MT Totals,	170 Institutions	6,785,894	525,060	7.65	609,686	8.89	2.31	2.73	0.34	0.60	19,544	1.14	4.26	0.27	1.07	(0.02)	3.48
NE Totals,	409 Institutions	17,359,090	1,467,568	8.50	1,645,295	9.53	2.03	1.29	0.39	0.33	55,744	1.29	4.37	0.32	1.69	(0.03)	3.94
NV Totals,	17 Institutions	13,334,515	859,726	6.38	1,085,234	8.06	2.24	0.76	1.48	0.26	86,766	2.58	7.37	1.38	1.56	(0.00)	4.32
NH Totals,	52 Institutions	9,314,243	630,904	6.84	718,689	7.79	1.18	0.87	0.82	0.13	29,319	1.27	5.83	0.97	0.60	0.01	3.56
NJ Totals,	126 Institutions	85,000,129	5,650,905	6.66	6,569,451	7.74	1.43	1.35	0.28	0.05	250,837	1.18	4.12	0.30	0.94	0.02	3.13
NM Totals,	93 Institutions	10,248,428	767,841	7.54	858,314	8.43	1.62	2.72	0.50	0.95	25,810	1.01	4.23	0.44	1.05	(0.00)	3.51
NY Totals,	203 Institutions	690,288,302	37,725,198	5.53	55,715,657	8.17	3.80	5.27	0.52	0.10	1,267,958	0.76	2.66	0.29	1.95	0.02	3.06
NC Totals,	71 Institutions	69,877,207	4,292,107	6.36	4,759,575	7.05	1.19	0.50	0.17	0.13	182,936	1.08	3.30	0.22	1.36	0.00	3.02
ND Totals,	160 Institutions	6,819,148	570,925	8.37	651,759	9.56	2.27	1.55	0.36	0.39	16,026	0.94	3.92	0.41	0.72	(0.00)	2.96
OH Totals,	296 Institutions	102,136,126	7,168,300	7.18	8,039,476	8.06	1.48	1.16	0.72	0.07	302,939	1.21	4.20	0.58	1.28	(0.04)	3.35
OK Totals	458 Institutions	25,842,263	1,972,879	7.65	2,283,899	8.86	2.77	4.36	1.42	1.88	26,202	0.41	3.74	0.60	1.25	(0.01)	3.75
OR Totals,	52 Institutions	20,089,794	1,359,418	7.12	1,525,831	7.99	1.32	1.23	0.84	0.23	56,498	1.18	4.55	0.57	1.33	(0.00)	3.59
PA Totals,	296 Institutions	159,621,237	9,700,015	6.16	12,183,410	7.74	2.12	2.11	0.57	0.16	407,556	1.04	3.28	0.30	1.25	(0.00)	2.91
RI Totals,	12 Institutions	14,391,944	937,309	6.70	1,205,917	8.63	1.90	1.50	0.79	0.51	44,569	1.28	3.89	0.54	2.21	0.01	3.68
SC Totals,	80 Institutions	21,240,256	1,448,534	7.03	1,595,892	7.75	1.26	0.48	0.34	0.09	53,744	1.04	4.01	0.34	1.06	(0.01)	3.37
SD Totals,	132 Institutions	19,124,078	1,521,247	7.52	1,707,593	8.44	2.46	1.25	4.18	0.12	125,372	2.48	6.41	3.37	6.04	(0.05)	5.76
TN Totals,	267 Institutions	44,188,258	3,268,697	7.61	3,713,018	8.65	1.48	1.10	0.50	0.28	104,167	0.97	3.84	0.41	1.24	0.00	3.41
TX Totals,	1,436 Institutions	168,298,765	8,313,560	5.36	10,566,090	6.81	2.67	5.71	2.23	2.01	(17,148)	(0.04)	2.88	0.89	1.48	(0.01)	3.41
UT Totals,	57 Institutions	11,095,756	813,378	7.38	954,140	8.66	2.12	1.90	1.21	0.91	18,123	0.66	4.46	0.85	1.17	(0.01)	3.90
VT Totals,	26 Institutions	5,471,492	399,380	7.40	433,878	8.04	0.92	0.83	0.22	0.08	16,837	1.25	4.72	0.34	1.04	(0.00)	3.67
VA Totals,	186 Institutions	60,935,436	4,103,446	6.81	4,686,152	7.78	1.07	0.49	0.43	0.09	171,976	1.14	3.97	0.39	1.14	0.01	3.26
WA Totals,	88 Institutions	33,429,334	2,268,879	6.91	2,631,026	8.01	1.54	1.54	0.37	0.50	103,252	1.26	4.78	0.52	1.83	0.00	4.42
WV Totals,	197 Institutions	16,292,686	1,432,024	8.86	1,526,983	9.45	1.19	0.87	0.45	0.33	45,182	1.12	3.97	0.25	0.57	(0.00)	2.83
WI Totals,	517 Institutions	41,820,571	3,339,726	8.03	3,696,078	8.90	1.31	1.20	0.28	0.21	123,191	1.19	3.98	0.26	1.17	(0.01)	3.29
WY Totals,	88 Institutions	4,081,087	257,235	6.63	305,251	9.95	2.33	2.80	0.87	0.56	10,344	1.00	4.18	0.20	0.90	(0.00)	3.54
AQ Totals,	1 Institution	32,864	3,725	11.91	3,982	12.73	1.68	0.63	0.70	0.00	118	1.51	5.38	0.13	0.97	0.00	4.28
GU Totals,	1 Institution	359,590	30,124	8.48	31,577	8.89	1.26	0.03	0.69	0.02	2,072	2.33	5.85	0.45	1.18	0.00	4.19
PR Totals,	15 Institutions	14,236,333	925,416	6.65	1,027,943	7.39	1.39	2.04	0.70	0.11	37,679	0.80	3.63	0.52	0.73	0.00	3.17
TQ Totals,	1 Institution	8,962	650	7.11	668	7.20	0.98	0.10	0.89	0.00	(38)	(1.68)	4.38	0.00	0.53	0.00	6.67
Gr. Totals,	13,000 Institutions	$3,150,080,643	$201,864,234	6.52%	$251,902,640	8.14%	2.36%	2.56%	0.74%	0.38%	$7,323,874	0.95%	3.62%	0.46%	1.53%	0.01%	3.36%

Risk to the deposit insurance fund

Looking ahead, at the end of the first quarter of 1989, there were 443 banks with total assets of almost $35 billion still operating that had net operating losses in 1987, 1988 and the first quarter of 1989. This listing excludes the subsidiary banks of two Texas holding companies whose losses were reserved by the FDIC in 1988, Texas American Bancshares and National Bancshares Corp.

The equity capital ratio of this group of banks has dropped from 7.34 percent at the end of 1986 to 4.36 percent at the end of the first quarter of 1989.

Correspondingly, the losses for this group have accelerated from $117 million in 1986 to more than $837 million in 1988. They had losses in the first quarter of 1989 of approximately $181 million.

The ratio of nonaccrual loans to total loans for this group has increased from 4.68 percent at the end of 1986 to 7.19 percent at the end of the first quarter of 1989.

Again, regional economic factors strongly influence the profitability of these banks. Of these 443 banks, 181 were located in Texas, 49 were based in Colorado, 31 were in Florida, 27 were located in Oklahoma and 21 in Louisiana.

If the present earnings trends for these banks continue, this group will run out of capital between late-1990 and mid-1991. Assuming a gross resolution cost to BIF of 25 percent of total assets, total costs to BIF could be in the range of $8 billion to $9 billion for this group.

Clearly many of these institutions are candidates for early intervention by the FDIC.

The outlook

The prospective condition of the banking industry and BIF is strongly influenced by three factors: LDC debt, regional economic trends and real estate lending.

LDC debt. The valuation of LDC debt is an issue that affects a few primarily money center banks. However, the valuation of such debt has a significant potential impact on the balance sheets of these institutions. Because of the special role and visibility of these banks, this issue has an impact on the stability of the entire banking and financial system.

Clearly, defaults—either formal or informal—pose substantial financial risks to a handful of money center banks that are not likely to be permitted to fail.

Although some progress has been made toward appropriately reserving against these assets, money center banks probably have a long way to go in developing adequate reserves for their LDC portfolios.

I understand the argument in favor of "quiet diplomacy" on this matter among the regulators, the money center banks and other interested parties. However, it might make sense for the congressional banking committees to set specific bench marks for improved reserves for these assets during the next several years and to direct the General Accounting Office to monitor performance of the banking agencies and banks in meeting those stiffer and more realistic reserve requirements.

Regional economic trends. The economic collapse of the Southwest economy has posed a severe test for

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the present depository insurance and regulatory systems. Moreover, other regional economies can be expected to suffer similar, if not so severe, economic downturns. The regulators now have the powers, resources and political will to contain and minimize the financial damage to the banking system inherent in any normal regional economic cycle.

Real estate lending. In rough numbers, commercial bank real estate loans outstanding have been growing at a rate of $100 billion per year, in spite of strong competition from the thrift and mortgage banking industries. At the end of the first quarter of 1989, there were 7,832 banks with assets of $1.18 trillion that had more than 40 percent of their loan portfolios in real estate loans.

In short, many banks resemble thrift institutions if you just look at their loan portfolios—with a substantial portion of real estate loans in residential mortgages. Clearly, this trend will increase the exposure of banks to interest rate risk. After all, it was interest rate risk exposure in the late seventies and early eighties that destroyed the capital base of the savings and loan industry.

In a post-FIRREA era, there will be greater opportunities for banks to increase real estate lending because of a substantial reduction in the number of savings institutions and the capital-driven regulatory constraints on the growth of many remaining thrifts.

Moreover, if commercial real estate lending is a risky activity for a thrift, is it not equally risky for a commercial bank? Should the FIRREA constraints imposed on such lending activity by thrifts be extended to commercial banks?

It seems unreasonable to limit by law thrifts' loan portfolio exposure without at least evaluating the exposure of commercial banks to the same risks. Moreover, risk-based capital rules will encourage banks to make long-term residential mortgage loans, exposing them to the potential double jeopardy of asset specialization and increased interest rate risk.

There is a real question in my mind as to the wisdom of setting a low minimum core capital requirement for banks unless an interest rate risk component is simultaneously established as an integral part of a bank's risk-based capital requirements.

Cautious optimism

With the new powers bank regulators gained under FIRREA, and the regulatory reforms suggested, a modified version of our present deposit insurance and bank regulatory system should meet foreseeable needs.

The existing depository, supervisory and regulatory system can be modified and modernized to work effectively at least through the first half of the 1990s and achieve our public policy goals of a relatively stable, safe and sound financial system without undue additional financial risks to the insurance fund and the Treasury.

Looking beyond the mid-1990s, it is too early to tell what kind of a financial system will evolve. More radical reforms in our regulatory system may be appropriate as a new set of private market institutions develops. **MB**

William C. Ferguson is chairman and CEO of Ferguson & Co., a financial institution consulting firm that has offices in Irving, Texas, and Washington, D.C.

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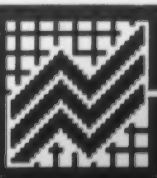

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VITAL STATISTICS

INTEREST RATES & YIELDS
1- TO 4-FAMILY MORTGAGES

1989	FHA OPINION SURVEY: FHA New Homes[1]	FHLBB: CONVENTIONAL[2] FRM	FHLBB: CONVENTIONAL[2] ARM	FHLBB: Median Cost of Funds FSLIC Institutions	FNMA: 1-Yr. ARM	FNMA: FRM Conv.	FHLMC: ARMs	FHLMC: FRMs
JUL	9.85%	10.66%	9.84%	8.07%	8.24%	9.72%	8.74%	9.88%
AUG	9.78	10.30	9.56	8.08	9.95	9.40	8.65	9.99
SEP	9.95	10.34	9.62	NA	8.54	10.06	8.71	10.13
OCT	**NA**	**NA**	**NA**	**NA**	**9.81**	**8.30**	**8.62**	**9.95**

SELECTED SECURITIES

1989	FEDERAL FUNDS RATE	PRIME COMMERCIAL PAPER (3-Month)	U.S. GOVERNMENT: 6-Month	U.S. GOVERNMENT: 1-Year	U.S. GOVERNMENT: 3-Year	U.S. GOVERNMENT: 10-Year	A-Rated Utility
JUL	9.24%	8.68%	7.61%	7.89%	7.83%	8.02%	9.54%
AUG	8.99	8.57	7.74	8.18	8.13	8.11	9.55
SEP	9.02	8.70	7.74	8.22	8.26	8.19	9.55
OCT	**8.84**	**8.53**	**7.62**	**7.99**	**8.02**	**8.01**	**9.39**

CURRENT SECONDARY MARKET YIELDS

SPREADS
(Basis Points)

1989	GNMA[3]	FNMA[3]	FHLMC[3]	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
JUL	9.44%	9.47%	9.48%	142	145	146
AUG	9.49	9.53	9.53	138	142	142
SEP	9.52	9.54	9.53	133	135	134
OCT	**9.40**	**9.42**	**9.42**	**139**	**141**	**141**

SECONDARY MARKET ACTIVITY
(Dollars in Millions)

1989	FNMA: Portfolio Commitments	FNMA: Portfolio Purchases	FNMA: Mortgage-Backed Securities Outstanding	FNMA: Mortgage-Backed Securities Issued	FHLMC: Commitments To Sell	FHLMC: Commitments To Buy	FHLMC: Mortgages Purchased	FHLMC: PCs Issued	GNMA: Pass-Through Securities Applications	GNMA: Pass-Through Securities Issued
JUN	$2,573	$1,862	$196,501	$4,339	$7,753	$7,948	$7,392	$6,551	$3,267	$4,138
JUL	2,513	2,091	200,468	5,464	5,934	6,608	5,720	5,180	4,395	4,895
AUG	2,842	2,724	203,923	5,081	7,852	5,705	7,283	8,650	6,161	5,463
SEP	**2,328**	**2,223**	---	**6,883**	**7,979**	**7,708**	**7,889**	**8,050**	**5,181**	**5,740**
1988 TOTAL	23,435	23,110	---	54,878	41,271	70,669	44,075	39,777	58,578	56,531
1987 TOTAL	25,415	20,531	---	63,230	68,210	76,615	76,840	75,018	116,611	96,983
9 MONTH AVG. 1989	2,157	1,655	---	4,922	6,409	6,660	6,037	5,645	4,380	4,534
1988	2,117	2,033	---	4,363	3,086	5,346	3,343	2,929	4,765	4,663
1987	1,982	1,579	---	5,593	6,774	7,204	7,502	7,329	11,854	9,090

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES

(Units in Thousands, Seasonally Adjusted Annual Rates)

	BY TYPE OF UNIT						BY REGION							
	HOUSING STARTS			BUILDING PERMITS			HOUSING STARTS				BUILDING PERMITS			
1989	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Northeast	Midwest	South	West	Northeast	Midwest	South	West
JUN	1,406	1,027	379	1,308	940	368	168	242	552	444	177	234	506	391
JUL	1,420	1,083	337	1,281	979	302	189	274	531	426	160	232	478	411
AUG	1,332	1,045	287	1,328	1,004	324	145	236	565	386	174	263	517	374
SEP	**1,263**	**1,022**	**241**	**1,296**	**999**	**297**	**170**	**243**	**477**	**373**	**168**	**246**	**499**	**383**
1988 TOTAL	1,488	1,140	348	1,456	1,070	386	235	274	575	404	230	266	544	416
1987 TOTAL	1,621	1,212	409	1,535	1,114	421	269	298	634	420	272	282	575	406
9 MONTH AVG. (SAAR)														
1989	1,403	1,075	328	1,335	1,007	328	192	267	548	395	186	256	507	385
1988	1,470	1,132	338	1,424	1,063	361	254	267	561	389	245	262	531	386
1987	1,668	1,248	420	1,581	1,147	433	280	317	637	432	281	300	586	414

HOME SALES

(Units in Thousands)

	EXISTING HOMES			NEW HOMES		
1989	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate
JUN	3,360	2,350	8.4	647	377	7.2
JUL	3,330	2,260	8.2	742	370	6.1
AUG	3,480	2,330	8.0	719	367	6.3
SEP	**3,630**	**2,250**	**7.4**	**618**	**367**	**7.6**
1988 TOTAL	3,594	---	---	676	---	---
1987 TOTAL	3,526	---	---	671	---	---
9 MONTH AVG. (SAAR)						
1989	3,427	---	---	651	---	---
1988	3,517	---	---	672	---	---
1987	3,571	---	---	687	---	---

VALUE OF NEW PRIVATE CONSTRUCTION PUT IN PLACE

(Units in Billions of 1982 Dollars, Seasonally Adjusted Annual Rates)

	Total[a]	1-Unit	2+ Units	Nonresidential
JUN	$280.0	$97.3	$19.9	$80.1
JUL	274.5	97.0	20.0	78.8
AUG	274.3	95.4	19.6	81.4
SEP	**270.8**	**94.4**	**19.2**	**79.2**
1988 TOTAL	281.8	103.5	19.3	77.9
1987 TOTAL	283.0	100.7	22.4	78.2
9 MONTH AVG. (SAAR)				
1989	279.5	99.4	19.9	80.2
1988	279.2	102.7	19.4	77.7
1987	281.4	99.6	22.7	77.2

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Type of Unit
(Dollars in Millions)

	1-4 UNITS					5+ UNITS					NONRESIDENTIAL				
	Total[1]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[1]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[1]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies
1989															
APR	$27,890	$5,530	$13,233	$8,730	$85	$2,480	$331	$1,206	$366	$221	$8,917	$122	$1,340	$5,216	$2,104
MAY	29,269	5,302	13,270	10,179	132	2,290	286	981	640	166	13,301	186	1,476	8,404	3,094
JUN	29,495	5,477	12,327	11,120	157	2,268	159	971	698	134	13,208	95	1,246	8,773	2,976
JUL	**27,273**	**5,522**	**10,819**	**10,390**	**200**	**1,733**	**296**	**680**	**407**	**222**	**15,597**	**135**	**835**	**12,533**	**1,967**
1988															
TOTAL	374,401	85,307	186,237	95,474	3,190	37,876	4,526	20,379	6,988	3,553	175,754	1,032	22,953	119,942	29,714
1987															
TOTAL	449,544	110,093	208,054	124,551	3,209	44,981	2,409	22,492	8,299	3,547	168,652	2,871	25,613	110,490	28,160
7 MONTH AVG.															
1989	27,466	5,372	12,518	9,075	108	2,396	274	1,169	536	183	11,716	109	1,353	8,048	2,075
1988	29,669	7,057	14,367	7,706	202	2,934	380	1,559	565	277	14,567	61	1,846	10,536	1,908
1987	42,001	11,088	18,575	11,747	318	4,221	209	1,859	836	266	12,902	307	2,048	8,575	1,885

MORTGAGE INSURANCE
(Units in Thousands, Dollars in Millions)

	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	TOTAL	FHA[8]	VA	PRIVATE	TOTAL		FHA		VA		PRIVATE	
					Units	Amount	Units	Amount	Units	Amount	Units	Amount
1989												
JUN	157	96	15	46	107	$8,155	60	$3,774	14	$1,072	33	$3,309
JUL	153	92	14	47	94	7,411	48	3,060	13	985	33	3,366
AUG	177	110	18	49	105	8,208	55	3,511	14	1,102	35	3,595
SEP	**147**	**85**	**16**	**46**	**116**	**8,981**	**68**	**4,326**	**13**	**1,033**	**35**	**3,622**
1988 TOTAL	1,755	949	211	595	1,334	98,012	699	42,577	211	15,771	424	39,664
1987 TOTAL	2,340	1,211	408	721	2,282	159,668	1,320	81,881	451	33,312	511	44,475
9 MONTH AVG.												
1989	143	85	16	42	101	7,717	57	3,581	15	1,146	29	2,990
1988	153	84	17	52	111	8,187	58	3,544	17	1,298	36	3,345
1987	220	118	39	63	209	14,561	123	7,665	42	3,082	44	3,814

NA—Not Available; SAAR—Seasonally Adjusted Annual Rate

[1]Secondary market gross yields. Numbers shown for each month are the average of yields from the first day of the month shown and the first day of the subsequent month.

[2]Effective rate on loans closed.

[3]Securities for 0- to 30-day delivery.

[4]In addition to the categories of private construction shown, the total also includes these categories: residential improvements, railroads, electric light and power, gas, telephone and telegraph, petroleum pipelines, and farm nonresidential.

[5]In addition to the categories shown, the total also includes private pension funds, private MBS conduits, state and local retirement funds, federal credit agencies, mortgage pools, and state and local investment agencies.

[7]Savings & Loans and Mutual Savings Banks.

[8]FHA applications received includes the Direct Endorsement Program.